

**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

WISCONSIN ENERGY CORPORATION, )  
INTEGRYS ENERGY GROUP, INC., )  
PEOPLES ENERGY, LLC, THE PEOPLES )  
GAS LIGHT AND COKE COMPANY, NORTH )  
SHORE GAS COMPANY, ATC )  
MANAGEMENT INC. AND AMERICAN )  
TRANSMISSION COMPANY LLC )

)  
Application pursuant to Section 7-204 of the )  
Public Utilities Act for authority to engage in a )  
Reorganization, to enter into agreements with )  
affiliated interests pursuant to Section 7-101, and )  
for such other approvals as may be required )  
under the Public Utilities Act to effectuate the )  
Reorganization. )

Docket No. 14-0496

Surrebuttal Testimony of

**JOHN J. REED**

CEO – Concentric Energy Advisors, Inc.

On Behalf of

Wisconsin Energy Corporation

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1   **I.   INTRODUCTION AND PURPOSE**

2   **Q.   Please state your name, affiliation, and business address.**

3   A.   My name is John J. Reed. I am Chairman and Chief Executive Officer of Concentric  
4       Energy Advisors, Inc. (“Concentric”) and CE Capital, Inc. located at 293 Boston Post  
5       Road West, Suite 500, Marlborough, Massachusetts 01752.

6   **Q.   Have you previously filed testimony in Docket No. 14-0496?**

7   A.   Yes, I have submitted direct and rebuttal testimony on behalf of Wisconsin Energy  
8       Corporation (“WEC”) in support of the application that was filed by WEC and Integrys  
9       Energy Group, Inc. (“Integrys”) requesting approval of a proposed reorganization  
10      pursuant to Section 7-204 of the Public Utilities Act of Illinois.

11  **Q.   In response to what witnesses did you provide rebuttal testimony?**

12  A.   I filed rebuttal testimony in response to the direct testimonies of Mr. Michael McNally  
13      and Mr. Eric Lounsberry on behalf of the Staff of the Illinois Commerce Commission  
14      (“Commission”), and to the direct testimony of Mr. Michael P. Gorman on behalf of the  
15      City of Chicago (“City”) and the Citizens Utility Board (“CUB”).

16  **Q.   What is the purpose of your surrebuttal testimony in this proceeding?**

17  A.   The purpose of my surrebuttal testimony is to respond to certain aspects of the rebuttal  
18      testimonies of City/CUB witness Mr. Gorman and Mr. Sebastian Coppola who filed  
19      rebuttal testimony on behalf of The People of the State of Illinois.

20 **Q. Do you plan to file surrebuttal testimony in response to Mr. Lounsberry or Mr.**  
21 **McNally?**

22 A. No. I filed rebuttal testimony in response to Mr. Lounsberry's concerns regarding  
23 WEC's due diligence of Integrys. In his rebuttal testimony, Mr. Lounsberry states that he  
24 no longer considers this significant enough to conclude the proposed reorganization does  
25 not meet the requirement of 7-204(b)(1).<sup>1</sup> As such, I have no further response to Mr.  
26 Lounsberry's testimony.

27 I also filed rebuttal testimony in response to Staff witness McNally's questions about  
28 whether the proposed reorganization satisfies the requirements of Section 6-103 (which  
29 requires that in any reorganization, the Commission shall authorize the amount of  
30 capitalization of a public utility formed by a reorganization, which shall not exceed the  
31 fair value of the property involved) and Section 9-230 (which prohibits the Commission  
32 from reflecting in rates any incremental risk or increased cost of capital which is the  
33 result of a public utility's affiliation with non-utility companies). Mr. McNally did not  
34 provide rebuttal testimony in response to my testimony, so I have nothing further to add  
35 in response to Mr. McNally.

36 **Q. Please summarize the conclusions and recommendations in your surrebuttal**  
37 **testimony.**

38 A. Nothing in the rebuttal testimonies of Messrs. Gorman or Coppola alters my view that the  
39 proposed reorganization (1) meets the statutory requirements in Illinois, (2) satisfies the  
40 Commission's standard of review, and (3) should be approved by the Commission.

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<sup>1</sup> ICC Staff Exhibit 9.0, at 27.

41 **II. RESPONSE TO MR. COPPOLA’S REBUTTAL TESTIMONY**

42 **Q. Please briefly summarize Mr. Coppola’s rebuttal testimony and recommendations.**

43 A. Mr. Coppola expresses concern regarding the amount of due diligence regarding the  
44 Accelerated Main Replacement Program (“AMRP”) that was performed in the pre-  
45 merger phase, which Mr. Coppola believes raises grave concerns about WEC’s  
46 understanding of the current state of the AMRP and its priorities and commitments to  
47 complete the AMRP in a way that will not harm customers if the merger is approved.<sup>2</sup>

48 **Q. How do you respond to Mr. Coppola’s stated concerns?**

49 A. Mr. Coppola’s concern was largely addressed in my rebuttal testimony in response to Mr.  
50 Lounsberry.<sup>3</sup> The due diligence that was performed related to the potential merger was  
51 typical of what I have seen from other mergers. In particular, the due diligence process  
52 included sharing non-public financial information and projections, operational data,  
53 capital investment plans, and strategic outlooks between management of the two  
54 companies, as well as their financial advisors and outside experts. The AMRP, as  
55 described in Liberty Consulting Group’s interim report, is one of the country’s largest  
56 utility construction programs.<sup>4</sup> The operational challenges facing the Joint Applicants  
57 will not be solved overnight, but WEC is keenly aware of the AMRP and the problems  
58 and concerns that have been raised with the oversight of the initiative.

59 As stated by Joint Applicants witness Leverett, in both his direct and rebuttal  
60 testimonies, WEC will be subject to any and all existing obligations established by the  
61 orders of this Commission, including such obligations associated with The Peoples Gas

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<sup>2</sup> AG Exhibit 4.0, at 18.

<sup>3</sup> See Rebuttal Testimony of John J. Reed, at 12-13.

<sup>4</sup> ICC Staff Exhibit A, at S-1.

Light and Coke Company's ("PGL") AMRP.<sup>5</sup> The obligation for PGL and North Shore Gas Company ("NSG") to provide safe and reliable service is clear, and PGL's commitment to implement the AMRP in a timely and prudent manner, under WEC Energy Group ownership, is facilitated by the proposed reorganization.

**III. RESPONSE TO MR. GORMAN'S REBUTTAL TESTIMONY**

**Q. Does Mr. Gorman continue to believe that a rate freeze should be a condition of the Commission's approval of the merger?**

A. Yes, he does. While he provides additional testimony regarding his position, he fails to address the flaws and criticisms regarding his proposal that I cited in my rebuttal testimony.<sup>6</sup>

**Q. Please explain.**

A. Mr. Gorman's proposed rate freeze is tantamount to imposing additional standards for the approval of the proposed merger. The standards for approval that I cited in my direct testimony that the Commission should address when reviewing and approving a proposed reorganization do not warrant or require a rate freeze in this case.

In my rebuttal testimony, I provided a detailed critique of Mr. Gorman's proposed rate freeze.<sup>7</sup> I explained that he has not established a link between the risk reduction provided by regulatory mechanisms and riders and the value enhancement that he believes will occur as a result of the proposed reorganization.

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<sup>5</sup> Joint Applicants Ex. 6.0, at 15.

<sup>6</sup> Rebuttal Testimony of Michael P. Gorman, at 3-4.

<sup>7</sup> Rebuttal Testimony of John J. Reed, at 15-16.

81           While I understand that Mr. Gorman seeks to derive some benefit for his clients  
82           from the proposed reorganization, the rate freeze is unnecessary and not the vehicle by  
83           which to derive benefits. As the Joint Applicants integrate their management, systems  
84           and operations, they expect that savings, net of transition costs to achieve those savings,  
85           will be realized over time. These savings will be reflected in future rate proceedings for  
86           the benefit of Illinois customers by way of reduced operating expenses or lower capital  
87           costs. Imposing a five year rate freeze, as proposed by Mr. Gorman, is unnecessary to  
88           meet the established merger standard and is opportunistic and inequitable.

89   **Q.   Does Mr. Gorman continue to recommend that the Joint Applicants not be allowed**  
90   **to include transition costs in their cost of service for retail rates in Illinois?**

91   A.   Mr. Gorman's position in rebuttal is somewhat different on the issue of transition costs.  
92       Mr. Gorman now states that to the extent the Joint Applicants implement procedures that  
93       require them to incur costs that produce savings, the Joint Applicants should be allowed  
94       to recover the cost up to the level of savings created. Mr. Gorman indicates that the  
95       burden of proving that the transition cost is reasonable and created documented savings  
96       should be on the Joint Applicants. Finally, Mr. Gorman asserts that permitting the Joint  
97       Applicants to include transition costs in the development of rates should be clearly  
98       limited by the principle that transition costs will never be allowed to increase the Joint  
99       Applicants' revenue requirement and retail rates.<sup>8</sup>

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<sup>8</sup> Rebuttal Testimony of Michael P. Gorman, at 5-6.

100 **Q. How do you respond to Mr. Gorman's recommendation?**

101 A. Savings that are realized over time, and the transition costs necessary to achieve those  
102 savings, will be reflected through future rate cases. Mr. Gorman's position seeks to reap  
103 the savings associated with the merger, yet put the Joint Applicants at risk for the  
104 recovery of the costs incurred to achieve those savings. The Commission will have the  
105 opportunity to review the nature and reasonableness of the costs incurred to achieve any  
106 savings in those future rate proceedings. Recovery of such transition costs will be capped  
107 at the level of savings achieved, although the Joint Applicants expect that savings will  
108 significantly exceed the costs to achieve those savings.

109 **Q. Do the Joint Applicants propose to track and monitor actual savings and costs to**  
110 **achieve such savings?**

111 A. Yes. As discussed in the surrebuttal testimony of WEC witness Lauber, the Joint  
112 Applicants have committed to identify and track merger synergies and the transition costs  
113 necessary to achieve them. The Gas Companies will seek recovery of transition costs  
114 only to the extent that they are exceeded by acquisition-related savings. By committing  
115 to this undertaking, the Joint Applicants will be able to transparently demonstrate the net  
116 benefits of the Transaction and that these benefits are passed on to customers.

117 **Q. How do the Joint Applicants propose to track merger-related savings and transition**  
118 **costs?**

119 A. The Joint Applicants propose to develop a spreadsheet-based model which will operate in  
120 parallel with their accounting systems. Based upon my involvement with and knowledge  
121 of other utility mergers, this is an efficient and effective way to track merger-related



savings and transition costs. The model will be multi-layered, allowing very granular as well as higher-level tracking and will include:

- Functional level data rolled up into departmental reporting
- Departmental reporting rolled up into operating company reports
- Operating company reports rolled up into combined company reports

When initiating the tracking of merger-related savings and costs, it is important to start with a baseline, or the “but for the merger” cost levels against which future changes will be compared. It is equally important to actively assess and track the factors and circumstances affecting the baseline on a going forward basis. Not all of the changes that occur in the future will be attributable to the merger. For example, changes in environmental regulations or health care laws which would have occurred regardless of the merger should not be identified as producing merger-related cost impacts. Accordingly, the tracking of merger-related savings and the costs to achieve them is a very active process which requires frequent updating and analysis.

As discussed in the direct testimony of Joint Applicants witnesses, no transaction costs incurred to negotiate, draft, or execute the merger agreement, or to obtain the regulatory and shareholder approvals required to consummate the proposed reorganization, will be recorded on the books of the operating companies. Such transaction costs will be recorded at the parent company level and not allocated or assigned to the operating companies. As such, there is no need to report on the actual transaction costs incurred.

Transition costs, such as costs incurred to identify cost-reduction opportunities, to reorganize operations, or to consolidate information systems, or that are otherwise incurred for the purpose of reducing operating costs of the operating companies, would be recorded on the books of the operating companies or charged to the operating companies, in an appropriate proportion.

**Q. How do the Joint Applicants propose to report merger-related savings and “costs to achieve” to the Commission?**

A. The Joint Applicants propose to file the tracking mechanism and a detailed report explaining the merger-related savings and costs to achieve in its next base rate proceeding. The Joint Applicants propose to continue to file this information for at least five years, or for whatever duration the Commission determines is appropriate.

**Q. Will the accumulated net savings serve as an offset to any increased revenue requirement in future rate proceedings?**

A. Yes. The revenue requirement will be reduced by any net savings realized, thus ensuring that ratepayers reap the benefits of the merger.

**Q. Should the Commission attempt to pre-determine the nature or amount of transition costs that the Joint Applicants may incur associated with the merger and integration of the WEC and Integrys companies?**

A. No. While past mergers can provide some insights into a possible range of transition costs that may be incurred if the reorganization is approved, it would be inappropriate to limit or pre-establish the amounts of transition costs that may be incurred after the merger is approved.

165 **Q. Why would it be inappropriate for the Commission to limit the amount of transition**  
166 **costs that the merged companies could recoup?**

167 A. While the proposed reorganization is expected to produce savings, it is difficult at this  
168 point in time to accurately project the level of savings to be realized. Further, the Joint  
169 Applicants will be required to incur costs to achieve most savings. The ideal scenario for  
170 determining the level of savings realized and transition costs incurred to achieve those  
171 savings is to track actual costs through the rate case process and to define a mechanism  
172 by which to flow the actual savings, net of incurred costs, to the Gas Companies'  
173 customers. This could also have the unintended consequence of also limiting the amount  
174 of savings that can be achieved.

175 **Q. Please summarize Mr. Gorman's position with respect to the impact of the proposed**  
176 **reorganization on the financial condition of the combined company, WEC Energy**  
177 **Group.**

178 A. In supporting his ring fencing recommendation, Mr. Gorman asserts that the proposed  
179 transaction will increase the financial risk of the combined company. Specifically, Mr.  
180 Gorman states:

181 Because the Joint Applicants are paying a premium to the prevailing book  
182 value and market value of Integrys Energy Group, Inc., and propose to  
183 fund a large portion of that acquisition premium using additional  
184 acquisition related debt, the proposed transaction will create significantly  
185 more financial risk at WEC. This debt funding will place a significant  
186 financial burden on WEC after the transaction is completed.<sup>9</sup>

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<sup>9</sup> Rebuttal Testimony of Michael P. Gorman, at 14.

187 **Q. Do you agree with Mr. Gorman that the proposed reorganization will significantly**  
188 **increase the financial risk of the combined company?**

189 A. No, I strongly disagree with Mr. Gorman on this point. One of the key factors behind  
190 utility industry consolidation has been the desire to create a utility with the financial  
191 strength and scale to compete with larger utilities for access to capital on reasonable  
192 terms.<sup>10</sup> The utility industry is very capital intensive, and requires the regulated  
193 companies to continuously make investments in order to provide safe and reliable utility  
194 service to customers within their service territory. The AMRP is a good example of such  
195 requirements. Many small and mid-size companies, such as WEC and Integrys, have  
196 determined that, in order to compete effectively for the capital necessary to finance these  
197 investments, it is beneficial to consider mergers that form larger companies. While both  
198 WEC and Integrys have indicated that they would be able to continue raising capital even  
199 without the proposed reorganization, the important point is that the reorganization will  
200 *enhance* the combined company's ability to attract capital on reasonable terms. This  
201 enhanced financial strength and flexibility provide important benefits to ratepayers in  
202 Illinois, including 1) helping the combined company compete more effectively for equity  
203 capital on reasonable terms against larger utility holding companies, 2) allowing the  
204 operating companies to finance debt at lower interest rates that will be passed through to  
205 ratepayers in future rate proceedings, and 3) enabling the combined company to finance  
206 capital projects through internally-generated cash flow rather than going to the capital  
207 markets, thereby avoiding the incremental costs and fees associated with raising capital  
208 from external sources.

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<sup>10</sup> Direct Testimony of John J. Reed, at 13.

209           The implication of Mr. Gorman’s rebuttal testimony is that enhancing the Gas  
210 Companies’ access to capital doesn’t really provide any benefits to ratepayers, because  
211 the Gas Companies currently have access to capital without the proposed reorganization.  
212 Unfortunately, that perspective assumes that if the Gas Companies don’t proceed with the  
213 reorganization, the rest of the industry will also “stand still.” I can assure the  
214 Commission that won’t happen. Other transactions have been announced since the  
215 reorganization was announced, and more are almost certainly on the way. It is important  
216 to recognize that utilities compete with each other for access to capital (and, for that  
217 matter, for personnel, energy commodities, economic development opportunities, and  
218 many more resources), and in that competition, standing still means that you are in fact  
219 falling behind as other firms grow in size, scope, and capabilities. In this context, the  
220 reorganization is fully consistent with industry trends and directions.

221 **Q. Mr. Gorman alleges that the Commission needs assurances that PGL and NSG will**  
222 **prioritize system modernization and reliability improvements ahead of dividend**  
223 **payments to their parent company. How do you respond?**

224 A. Mr. Gorman’s arguments in his rebuttal testimony are largely recitations from his direct  
225 testimony. He has presented no new information to validate his alleged concern. I  
226 thoroughly addressed Mr. Gorman’s concerns in my rebuttal testimony.

227 **Q. Please respond to Mr. Gorman’s position that PGL and NSG should either limit**  
228 **their dividends payments, or eliminate dividend payments to WEC to the extent**  
229 **necessary to ensure that the capital improvements are made on a timely basis.**

230 A. As stated throughout my direct, rebuttal and surrebuttal testimony, I believe that the  
231 proposed reorganization will enhance the ability of WEC Energy Group to finance the

capital investment requirements of its operating utilities, including PGL and NSG. Mr. Gorman has provided no persuasive evidence that the Gas Companies will be unable or unwilling to continue making the necessary investments in their gas distribution systems unless the Commission imposes ring fencing requirements as a condition of merger approval. Mr. Gorman's recommendation appears to be derived from an overly simplistic view of corporate finance, *i.e.*, that an organization's decision to pay dividends is inversely related to opportunities to reinvest capital within the enterprise. That is not at all true for most utilities, and is certainly not true in these circumstances where the AMRP represents a viable and attractive investment opportunity. The limitation or elimination of dividends from the Gas Companies to WEC Energy Group is unnecessary, and would most likely have a detrimental effect on WEC Energy Group's ability to attract capital since many equity investors hold utility shares for the dividend payments.

**Q. What assurances has WEC provided that funding system modernization at PGL and NSG will be placed at a priority above making dividend payments from Illinois utilities to WEC?**

A. As I stated in my rebuttal testimony, WEC has committed to continue PGL's AMRP.<sup>11</sup> The Gas Companies' financial strength and credit metrics may be enhanced because WEC Energy Group's enhanced financial strength will enable the combined company to deploy its internally-generated cash flows to finance the capital investment requirements of PGL and NSG, especially those relating to the AMRP at PGL. The ability to finance capital expenditures through internal financing rather than going to external capital markets is a distinct advantage created by the reorganization and can be expected to lead

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<sup>11</sup> Rebuttal Testimony of John J. Reed, at 21.

254 to a stronger set of credit metrics. Simply stated, Mr. Gorman's proposed ring-fencing  
255 provisions are not necessary.

256 **Q. Does this conclude your surrebuttal testimony?**

257 A. Yes, it does.